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GRAY DRUG STORES, INC.

Annual report to shareholders
FOR THE YEAR ENDED JUNE 30, 1960

GRAY
DRUG STORES, INC.
AND SUBSIDIARIES

MAIN OFFICE and WAREHOUSE
2400 SUPERIOR AVENUE
CLEVELAND, OHIO

CITIES:	STORE UNITS: (June 30, 1960)
• Akron, O.	6
• Alliance, O.	1
• Ashtabula, O.	2
• Bradford, Pa.	1
• Canton, O.	4
• Chillicothe, O.	1
• Cincinnati, O.	7
• Cleveland, O.	21
• Columbus, O.	17
• Covington, Ky.	1
• Dayton, O.	7
• Dover, O.	1
• Fairborn, O.	1
• Fremont, O.	1
• Hamilton, O.	1
• Ithaca, N.Y.	1
• Lancaster, O.	1
• Lorain, O.	1
• Mansfield, O.	4
• Massillon, O.	2
• Middletown, O.	1
• Newport, Ky.	1
• Northfield, O.	1
• Painesville, O.	2
• Sandusky, O.	2
• Sheffield, O.	1
• Springfield, O.	1
• Stow, O.	1
• Steubenville, O.	2
• Warren, O.	4
• Willoughby, O.	1
• Wooster, O.	2
• Youngstown, O.	11

Gray Drug Stores, Inc. — the nation's eighth largest drug chain — operated 111 stores and employed approximately 2100 people as of June 30, 1960. Grays' stores — which dominate nearly every large city in Ohio, and border into Kentucky, Pennsylvania and New York — serve a vast majority of the three million homes in this trading area.

(* To open during current fiscal year.)

BOARD OF DIRECTORS

CARLYLE W. EVANS	President, Gray Drug Stores, Inc.
HENRY H. GRAY	Vice-President, Gray Drug Stores, Inc.
CHARLES B. MERRILL	President, Merrill, Turben & Co.
GEORGE F. PRYOR	Vice-President, The Cleveland Trust Co.
JOHN W. REAVIS	Partner, Jones, Day, Cockley & Reavis
ADOLPH WEINBERGER	Chairman of the Board, Gray Drug Stores, Inc.
CARL WEINBERGER	Buyer, Gray Drug Stores, Inc.

OFFICERS

ADOLPH WEINBERGER	Chairman of the Board
CARLYLE W. EVANS	President
LLOYD C. DOUGLASS	Vice-President & Treasurer
HERBERT H. DURR	Vice-President
HENRY H. GRAY	Vice-President
MARVIN L. KAHN	Vice-President
MILTON M. NEUBAUER	Vice-President
JEROME WEINBERGER	Vice-President
LOUIS BERWITT	Secretary
ROBERT E. BREIG	Assistant Treasurer
JOSEPH VALINS	Assistant Secretary

TRANSFER AGENT AND REGISTRAR

THE CLEVELAND TRUST COMPANY ..... Cleveland, Ohio

AUDITORS

ERNST & ERNST ..... Cleveland, Ohio

COUNSEL

JONES, DAY, COCKLEY and REAVIS ..... Cleveland, Ohio

STOCK LISTED

MIDWEST STOCK EXCHANGE ..... Chicago, Illinois

REPORT TO STOCKHOLDERS

We present in this report the results of your Company's 32nd year in operation.

Sales, income, and earnings per share were again the highest in our history. Net sales of $37,552,700 represent a 4.3% increase over the previous year's sales of $35,991,537. Consolidated net income after taxes of $793,989 is equivalent to $4.90 per share on 161,925 shares outstanding June 30, 1960, as compared to $768,591 or $4.75 per share on the same number of outstanding shares for last year.

During the year, your Company opened nine new stores, closed two, sold three, and remodeled fourteen. There were 111 stores in operation June 30, 1960, including four in cities where we had not previously been represented.

Our next fiscal year must be approached with caution. Unseasonable weather has slowed anticipated sales. In addition, the general economic softness is reflected in a slight decline of current sales from last year's level. Also, our gross profit margin is narrowing, because of a competitive price situation created principally by the advent of "health-and-beauty-aid discount stores." To take a realistic outlook, we can only foresee a continuation of this trend during the next few years.

This competitive problem is affecting the whole industry. Some drug chains are operating the drug and toiletries departments in various discount department stores. Thus far, such ventures have been successful, and the trend to such operations is expanding. In view of this, your Company now has under consideration the opening of leased drug and cosmetic departments in several discount department stores in various parts of the country. During the present fiscal year, we plan to open a number of units of this type. Such departments, of course, show a narrow gross-profit margin; however, they have the advantages of high volume, comparatively low capital investment, and short-term lease obligations. We view this move as a healthy diversification, and not as a transition from our conventional drug store operation. Leases have been signed for eight new drug stores to open in shopping centers during the current fiscal year, and others are being negotiated for the future.

The co-operation of our employees, stockholders and directors, and the continued confidence of our customers have helped us to complete another record year. To them all, we extend our since appreciation.

Respectfully,

Adolph Weinberger — CHAIRMAN OF THE BOARD

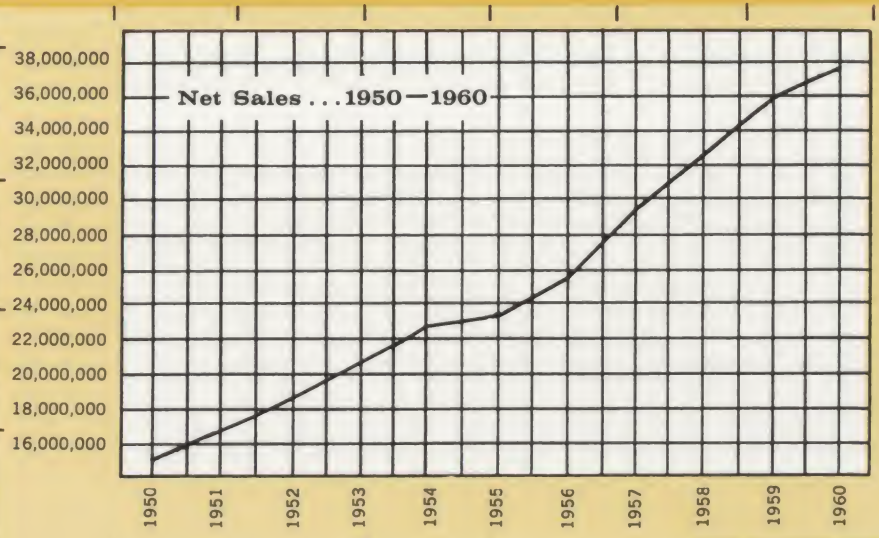
PRESIDENT

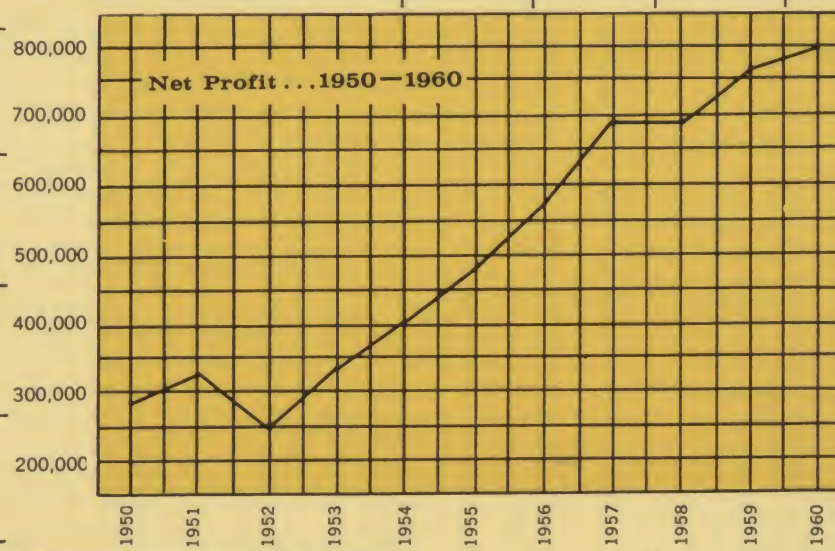
A few years ago your company recognized a new trend in drug store food-fountain operations: the need — especially in large regional shopping-centers — for a complete separate restaurant operation rather than the conventional "quick-lunch" counter.

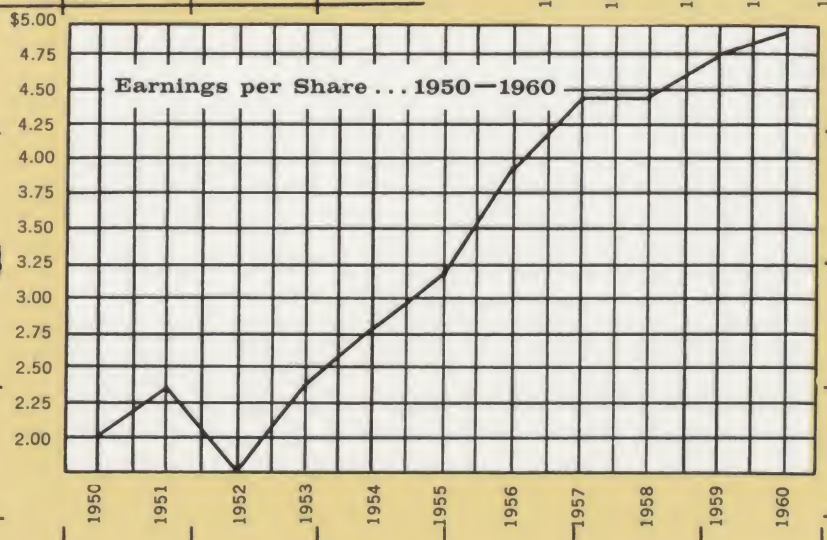
From that concept came the Gray's "Dutch Oven" restaurant — a separate room within the drug store where shoppers may relax in a pleasing atmosphere and enjoy anything from a sandwich to a full meal at low prices. These rooms combine the traditional counter with table service.

Of the 56 stores with food operations at this year-end, 15 were complete "Dutch Oven" restaurants. We expect to open three more during the coming year.

COMPANY GROWTH







THIRTY-TWO YEAR RECORD OF PROGRESS

Fiscal	Stores End of Year	Net Sales	Net Income (3)	Earnings Per Common Share (4)	Dividends Paid Per Share
1929	17	$ 1,531,636	$120,107	$1.94	$ .81
1930	21	2,136,818	88,655	1.18	.97
1931	24	2,604,609	100,482	1.30	.98
1932	26	2,547,357	87,893	1.16	1.00
1933	26	2,498,932	80,382	1.06	1.00
1934	29	3,201,663	112,408	1.49	1.00
1935 (1)	29	1,790,809	57,587	.76	.50
1936	33	4,406,753	163,774	2.05	1.05
1937	37	5,384,723	243,088	3.04	1.90
1938	38	5,374,763	132,821	1.66	1.60
1939	38	5,154,803	113,863	1.42	.50
1940	40	5,509,435	139,430	1.74	.75
1941	39	6,925,221	172,476	1.92	1.00
1942	44	7,965,870	176,651	1.96	.75
1943	43	9,135,763	193,896	2.15	.50
1944	43	9,469,467	172,278	1.91	.75
1945	78	10,003,588	175,407	1.78	1.00
1946	91	14,700,500	366,910	2.47	1.22½
1947	91	17,496,500	388,284	2.80	1.30
1948	78	16,227,105 (2)	293,263	2.11	1.30
1949	79	15,643,806	241,014	1.74	1.05
1950	77	15,283,817	281,994	2.03	.80
1951	74	16,833,818	324,702	2.32	.80
1952	80	19,268,081	250,767	1.78	1.00
1953	78	21,075,426	327,898	2.32	1.00
1954	80	22,578,421	407,643	2.85	1.00
1955	78	23,390,391	470,560	3.20	1.00
1956	81	25,543,059	576,429	3.92	1.10
1957	86	29,333,474	690,880	4.42	1.40
1958	102	32,249,706	692,322	4.43	1.40
1959	107	35,991,537	768,591	4.75	1.60
1960	111	37,552,700	793,989	4.90	2.00

(1) Six months ended June 30, 1935. Changed fiscal year from calendar year to one ending June 30.

(2) In addition to the drop in sales resulting from the sale of thirteen stores, at the beginning of this year state cigarette excise taxes are excluded from sales.

(3) Before reflecting reserves for contingencies which were restored to earnings retained in the business as of June 30, 1948.

(4) Based upon the number of shares outstanding at the end of each year, adjusted to reflect a stock split of 2 for 1 in February, 1930, and stock dividends of 3% in 1931 and 2% in 1932.

SELF-SERVICE=GREATER SALE

The concept of self-service merchandising today has invaded nearly every field of mass retailing. To the shopper — it offers the chance to shop at her own pace; to make fast purchases without waiting for a salesperson, or to browse and compare at her leisure. To the modern merchant — it offers a means of exposing thousands of items for "impulse" sales and increased volume; plus efficient, low-cost operation. Both have accepted and welcomed the self-serve store.

Nine years ago your Company recognized the importance of this trend, and opened our first experimental self-serve drug store. Since then, we have hastened our transition to self-serve merchandising in two ways: by opening practically all new stores as self-serve; and by remodeling and converting larger existing stores.

As of June 30, 1960, 67 of our 111 stores were self-serve units, and the conversion program will continue at an accelerated pace. On these pages we present a few views of a typical self-serve store.

S + EFFICIENCY

CONSOLIDATED

Gray Drug Stores Inc

ASSETS

	JUNE 30, 1960	JUNE 30, 1959
CURRENT ASSETS		
Cash	$ 842,498	$ 2,177,134
United States Treasury Bills — at cost plus accrued interest	1,086,239	— 0 —
Accounts receivable, less allowance of $30,000 in 1960, $10,000 in 1959	297,798	245,596
State tax stamps	139,781	130,626
Inventories — priced generally on the basis of the lower of cost (latest) or replacement market	7,961,472	7,007,798
Prepaid expenses	222,394	150,168
TOTAL CURRENT ASSETS	$10,550,182	$ 9,711,322
OTHER ASSETS	207,775	225,561
FIXED ASSETS — on the basis of cost		
Furniture, fixtures, and equipment	$ 3,717,133	$ 3,533,866
Leasehold improvements	2,357,059	2,226,255
	$ 6,074,192	$ 5,760,121
Less allowances for depreciation and amortization	2,717,613	2,434,925
	$ 3,356,579	$ 3,325,196
	$14,114,536	$13,262,079

BALANCE SHEET

and Subsidiaries

LIABILITIES AND SHAREHOLDERS' EQUITY

	JUNE 30, 1960	1959
CURRENT LIABILITIES		
Trade accounts	$ 2,278,780	$ 1,988,484
Salaries, wages, and commissions	477,973	422,923
Accrued expenses	444,472	461,269
Rent and interest	215,366	192,250
Payroll taxes and amounts withheld from employees	152,726	132,285
Taxes other than federal taxes on income	211,541	208,636
Federal taxes on income — estimated	682,079	674,772
TOTAL CURRENT LIABILITIES	$ 4,462,937	$ 4,080,619
5% CONVERTIBLE DEBENTURES DUE 1974 — Note A	2,313,500	2,313,500
SHAREHOLDERS' EQUITY		
Common Stock, par value $1.00 a share — Notes A and B:		
Authorized 500,000 shares		
Outstanding 161,925 shares	$ 161,925	$ 161,925
Capital in excess of par value	2,152,792	2,152,792
Earnings retained for use in the business — Note A	5,023,382	4,553,243
TOTAL SHAREHOLDERS' EQUITY	$ 7,338,099	$ 6,867,960
	$14,114,536	$13,262,079

See notes to financial statements.

STATEMENT OF

CONSOLIDATED EARNINGS

RETAINED FOR USE IN THE BUSINESS

GRAY DRUG STORES, INC. AND SUBSIDIARIES

	YEAR ENDED JUNE 30, 1960	1959
Balance at beginning of year	$ 4,553,243	$ 4,041,372
Net income for the year	793,989	768,591
	$ 5,347,232	$ 4,809,963
Cash dividends declared — $2.00 a share in 1960 and $1.60 in 1959 — Note C	323,850	256,720
Balance at end of year	$ 5,023,382	$ 4,553,243

See notes to financial statements.

STATEMENT OF

CONSOLIDATED INCOME

GRAY DRUG STORES, INC. AND SUBSIDIARIES

	YEAR ENDED JUNE 30, 1960	1959
Net sales	$37,552,700	$35,991,537
Cost of goods sold	23,362,858	22,508,484
	$14,189,842	$13,483,053
Other operating income	110,114	107,834
	$14,299,956	$13,590,887
Selling, general, and administrative expenses	12,560,105	11,967,995
	$ 1,739,851	$ 1,622,892
Other income	52,044	69,239
	$ 1,791,895	$ 1,692,131
Interest expense	117,906	84,540
INCOME BEFORE FEDERAL TAXES ON INCOME	$ 1,673,989	$ 1,607,591
Federal taxes on income — estimated	880,000	839,000
NET INCOME	$ 793,989	$ 768,591

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

GRAY DRUG STORES, INC. and SUBSIDIARIES
Year ended June 30, 1960

Note A — 5% Convertible Debentures due 1974:

The indenture under which the debentures were issued provides for annual sinking fund payments on February 15 of each year commencing in 1964. The amounts of such payments will be $115,675 from 1964 through 1968 and $161,945 from 1969 through 1973.

The debentures are convertible into shares of Common Stock of the Company at the option of the holder at any time on or before April 1, 1974, at a conversion price (subject to adjustment in certain events) of $47.50 per share until April 1, 1964, $52.00 per share thereafter until April 1, 1969, and $56.00 per share thereafter until maturity. At June 30, 1960, 48,706 shares of Common Stock are reserved for conversion of the debentures.

Under the terms of the indenture, earnings retained for use in the business in the amount of $1,578,904 are available for distribution to shareholders at June 30, 1960.

Note B — Stock options:

A stock option plan was approved by the Board of Directors on April 29, 1960, subject to the approval of the shareholders at a meeting to be held on September 30, 1960. As of June 30, 1960, options have been granted to certain officers (four of whom are directors) and key employees to purchase the 6,000 shares of Common Stock provided for by the plan. The options are exercisable at any time between two years and five years from April 29, 1960, and the option price is $47.50 per share (the approximate quoted market price at the date of grant) except that the option price for the principal shareholder and two employees related to him is $52.25 per share to permit qualification as a restricted stock option. The aggregate option price of all shares is $292,025.

Note C — Dividends:

The Company deposited funds with the dividend disbursing agent on June 29, 1960, for payment of the dividend payable July 1, 1960.

Note D — Long-term leases:

The companies were lessees at June 30, 1960, under a number of leases extending from one to seventeen years. The annual aggregate minimum rental payable under such leases (many of which provide for additional rental if amounts based on specific percentages of sales exceed the minimum) amounted to approximately $1,565,000.

Note E — Depreciation and amortization:

Allowances for depreciation and amortization of fixed assets amounted to $633,483 for the year ended June 30, 1960, and $575,139 for the year ended June 30, 1959.

Note F — Pension plan:

Total contributions under the pension plan for employees of the companies amount to approximately $150,000 for the year ended June 30, 1960, including amortization of the cost of past service benefits to retirement age of participants. At June 30, 1960, the unfunded cost of past service benefits was approximately $21,000.

ACCOUNTANT'S REPORT

Board of Directors
Gray Drug Stores, Inc.
Cleveland, Ohio

We have examined the consolidated financial statements of Gray Drug Stores, Inc. and subsidiaries for the year ended June 30, 1960. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet and statements of income and earnings retained for use in the business present fairly the consolidated financial position of Gray Drug Stores, Inc. and subsidiaries at June 30, 1960, and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

ERNST & ERNST
Certified Public Accountants

Cleveland, Ohio
August 26, 1960

GRAY
DRUG STORES